THE INHERITANCE TAX

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In this brief discussion of some salient principles and provisions of the inheritance tax it seems unnecessary to review its history or growth, except to say that until the adoption of the law of 1885 in New York, little consideration was given to it in this country. Since then, more especially in the last dozen years, the inheritance or transfer tax has been adopted into the taxing system of one state after another, until at the present time it is in force in about four-fifths of the states of the Union.

"Taxes" may be divided into two general classes: (1) Those which constitute a contribution by the taxpayer out of his substance to the support of government, such as most of our ordinary taxes, licenses and fees, especially the so-called "general property tax;" (2) Those which are merely a payment to the government of a portion of the social product, such as the royalty reserved upon mines and minerals, rental value of franchises, the proposed single land tax. The latter so-called taxes are no burden, being merely payment for value received.

The inheritance tax belongs to the first class, but is probably the least burdensome of that class of taxes; for, as prevailing in the several states, the rate is usually very moderate; it is paid out of property just acquired by the taxpayer,—usually property that has not caused the taxpayer any great effort in its acquisition. Its popularity is testified to by the fact of its rapid adoption by state after state in recent years.

The Wisconsin law is modeled upon the New York law as it existed prior to 1911 and is fairly typical of the laws prevailing in most of the states. Its salient features may be briefly summarized as follows:

The tax is in legal theory upon the transfer or the right to receive the property of the decedent, not upon the property itself. But the tax is measured by the amount of property passing to the beneficiary, and is made a lien upon such property, and a personal charge

against the executor and the beneficiary, until paid. A tax is imposed not only upon the transfer of property by will or intestate law, but also upon any transfer by deed, grant, bargain, sale or gift made in contemplation of death of the grantor, vendor or donor, or intended to take effect in possession or enjoyment at or after such death.

The primary rate is 1 per cent when the transfer is to husband, wife, children, father or mother; 1½ per cent to uncles, aunts, nieces and nephews; 3, 4 and 5 per cent to relatives further removed, according to degree of kindred; and 5 per cent to strangers in blood, corporations and other organizations, except municipal, religious, charitable and educational corporations within the state, which are exempt.

The above primary rates apply to the first $25,000 received by the beneficiary. The next $25,000 bears a rate of 1½ times the primary rate; the next $50,000 twice the primary rate; the next $400,000, 2½ times the primary rate; and all above $500,000, 3 times the primary rate. Thus it will be seen that a distant relative or a stranger in blood will pay 15 per cent upon the excess over a half million dollars that he may receive.

An exemption from the tax is allowed of $10,000 to a widow; $2,000 to each of the other relatives named in the first section; $500 to those in the second section; and lesser amounts to more distant relatives, down to $100 to those in the fifth class. These exemptions are taken out of the first $25,000.

The inheritance tax is imposed and collected during, and as a part of, the settlement of estates in the county or probate courts, and is usually paid by the executor and charged against the share which he is required to pay over to each beneficiary upon such settlement. This tax goes usually to the state for state purposes, except such small amount thereof as may be necessary to cover the expenses connected with its administration in court.

The above outline summarizes the law sufficiently for the general reader. It will be seen that the rate is light in the smaller estates and to near relatives, becoming heavier as the estate increases in size, and the relationship of the beneficiary becomes more distant; but becoming at no time exorbitant or particularly burdensome. In the smaller estates where the deceased leaves a widow and several children, the exemptions commonly exceed the value of the estate, no tax being paid. Ordinarily the procedure is simple and inexpensive,

and the tax is paid promptly by the executor or administrator of the estate out of ready money or other property in his hands.

However, a relatively small number of estates involve questions and situations that have caused much discussion, some litigation, and an amount of criticism that has assumed more heat, it is thought, than the facts warranted. If a decedent lived in one state and owned property in another state, to which state should the tax be paid? Quite early in the administration of the law it was decided that if the property is real estate, the tax is due to the state where the land is located. This rule has been affirmed repeatedly and has received general acquiescence.

Where, however, the foreign property is personal, it was early held to follow the residence of the owner and to be taxable in the state where the deceased had his domicile. But numerous states held that the property was taxable in the state where located, and in such cases the same property was subjected to double taxation. After eliminating all real estate, and all personal property located in the state of the owner's domicile, the property so subjected to double taxation is relatively unimportant in amount, and not sufficient in any sense to serve as a basis for condemnation of the law. Nevertheless, possible double or multiple taxation is a problem of sufficient moment to demand the careful attention of students and legislators.

The most common instances of such taxation occur in relation to corporate stocks and securities. An actual instance in point was where railroad stock of deceased was subject to the tax of Wisconsin because this state was his residence; in Illinois because the stock was physically in that state, being kept in a safety deposit box in Chicago; and in Utah because the railroad company is a Utah corporation.

Such cases are rare. The inheritance tax laws of most of the states are relatively new, and more or less imperfect. We may confidently expect that through state comity and the ordinary human sense of fairness such injustices will gradually be amended out of the laws.

An effort was made in New York to take a step in avoidance of such double taxation, by the exempting from taxation of stocks of New York corporations when left by a non-resident decedent, on the theory that corporate stocks are personal property and should be taxed only at the domicile of the decedent. The Wisconsin theory, and probably that of other western states, is that the stock is merely

the paper representative of the actual property and that all taxes, including the inheritance tax, should be imposed and collected at the place of location of the property. The property must be protected by, and at the expense of, the state where located. The rights of parties concerning such property must be enforced in the courts of that state. The people of the locality usually furnish the custom or business that supports the property and gives it value. Hence it is the locality that needs the tax for its public purposes and is equitably entitled thereto. New York, of course, finds its theory in full accord with its financial interests, for it is probable that only a relatively small amount of its domestic corporate stock is held without the state, while residents of New York are holders of immense quantities of foreign stock, the transfer tax upon which that state would hesitate to surrender.

The New York argument is based chiefly upon the proposition that the tax is not upon the property but upon the transfer. While this is the practically unanimous holding of the courts, and is the law, yet as an economic truth I submit that the proposition is open to serious doubt. As an economic proposition it is probably true that the inheritance tax is a tax upon the property, burdening the property to the extent of the tax, and reducing its market value to that extent, as much so as a direct tax of like amount and frequency. Dealers in securities, investors and promoters object strenuously to drastic inheritance tax laws, alleging that they tend to depreciate the selling value of securities, and make them undesirable as investments. This could not be true if the tax were not a burden upon the property itself.

The recent amendment to the Wisconsin law (section 1087–11, subsections 3–8, statutes of 1913) is intended as an important step toward the elimination of double taxation, without surrendering the right to tax the transfer of securities representing Wisconsin corporate property. It provides in substance that the stocks, bonds and other securities of a non-resident decedent shall be subject to the inheritance tax in this state at a value proportionate to the value which the Wisconsin assets of the corporation bear to the entire assets. It is true that this law does not cover the entire situation, nor have its administrative problems been fully worked out.

The purpose of this law is to place all forms of property in the state on the same basis as real estate, which is commonly conceded to be taxable only in the state of its situs. Even local real estate under

the New York law would not necessarily be subject to the inheritance tax, for in the larger cities great mercantile buildings, office and bank buildings, hotels, theatres and similar properties of tremendous values are frequently, perhaps commonly, owned by corporations; and such properties might pass for generations without coming within the purview of the inheritance tax law of the state where located if the transfer of stock is held to be taxable only at the domicile of the deceased stockholder. All of the stock might readily be held out of the state. Railroads, street railways, gas, electric and water plants, water powers, manufacturing plants, mines, quarries, all are chiefly real estate values, and are usually corporate properties, the stock of those in the newer states being held largely in the east and at the great commercial centers.

What has been said of stocks is equally true of bonds and mortgages. A mortgage must be considered, as it commonly is, an interest in the real estate, since the owner of the real estate after death has his debts, including the mortgage, allowed as a deduction in arriving at the net estate passing subject to the tax. Hence if the mortgage, held by a non-resident, should not be taxed upon the death of the owner, it would in reality take a large amount of real estate value from under the operation of the tax at the situs of the real estate. What is true of mortgages is true of bonds. A difficulty of enforcing the tax upon the transfer of bonds is that they may be transferred usually by manual delivery, except in the case of registered bonds; and it is not easy to know of their existence in a foreign estate, either on the part of the officials of this state or of the corporation.

Argument is frequently made on behalf of the inheritance tax as an economic measure, designed in some degree to reduce "swollen" fortunes. There is no basis for such argument; and a state tax heavy enough to have that effect would probably drive much of the liquid capital out of the state, and prevent capital from coming in. To be sure, the maximum rate in Wisconsin is 15 per cent, a rate that would cut materially into the principal of a bequest. But that rate has never been applied to any estate; and when it is recalled that it applies only to the excess over $500,000 of a bequest to a stranger, it may be surmised that it will not be applied very soon. Cases where the rate exceeds an average of 6 per cent are extremely rare. The average rate in the state is probably well under 2 per cent. As the tax is not payable until one year after death, it can in the vast majority

of estates be paid out of income without trenching upon the principal, even in the largest estates. No partial distribution of large estates to the public can be accomplished through present state inheritance tax laws. Such result might be attained by a heavy federal inheritance tax, if it did not do more harm than good by driving capital out of the country.

Serious objections to a national or federal inheritance tax present themselves. The inheritance tax is administered in the usual process of settling the estate in the probate courts. These are state courts over which the federal government has no jurisdiction nor control. With a federal inheritance tax it will become necessary for federal authorities to intervene in the state courts to protect the interests of the government and to collect the tax. The federal government to be effective would doubtless require its own appraisers, its own forms of notices, orders, records, reports and so on, duplicating the procedure of the probate court. All of this procedure must necessarily create a confusion of jurisdiction and of practice that would be irritating and expensive to the representatives of estates, and that in a great majority of cases would cause the estate a greater expense than the amount of tax derived by the government. It would also appear to be an unwise and improper encroachment by the federal government into a just and proper field of state taxation.

Whether the value of the dower and homestead interest of the widow in the estate of her husband should be included as a part of the taxable property of the estate, or allowed as a proper deduction in arriving at the net estate subject to the tax, is a question upon which the courts have disagreed widely. It is claimed on the one hand that dower comes to the wife by virtue of the marriage, and that the death of the husband serves only to consummate, not to transmit it; that it exists by virtue of the marriage relation, and does not accrue to the wife under the intestate laws of the state. Other courts hold that dower is an inchoate right or a mere expectancy becoming a vested right upon the death of the husband, and that this accretion of a vested right is such a devolution of property as is contemplated by the inheritance tax law.

In Billings *v.* People, 189 Ill. 472, the court held dower to be taxable as an interest in the estate of the husband passing to the wife on his death. In answer to the usual argument that dower is

a right existing during the marriage relation, and not created at the death of the decedent, the court says:

> There are no laws of this state which are specifically designated as "intestate laws," and we are called upon to say what laws or systems of laws were referred to under that appellation by the act in question. The same term is employed in similar statutes in other states, and we have no doubt the laws referred to are those laws of the state which govern the devolution of estates of persons dying intestate, and include all applicable rules of the common law in force in this state. The statutes from which we have above quoted are intestate laws, and they govern, regulate and control the interest which the widow took in her husband's property at his death. As a general rule, the property of persons dying passes in two ways—that is, by will, or by descent in the modes provided by law; and when it does not pass by will, it generally passes by law—that is, by the law governing the disposition of property of persons dying intestate.

A like rule was laid down by the California supreme court in relation to the widow's "community interest" in the estate of her husband, the court holding that "the interest of the wife in the community property is a mere expectancy." (Estate of Moffitt, 153 Cal. 359.) The California court in a later case, however, very inconsistently, it seems, held that the homestead interest of the widow in her husband's estate is not a taxable interest. (Estate of Kennedy, 157 Cal. 517.) The rule as to dower of the Illinois and California courts would appear to be the better and more consistent view. The widow is ordinarily allowed an exemption of $10,000 free from tax. This would appear to be a liberal allowance and should be held to cover all property passing to her from her husband's estate. Where the widow takes under her husband's will such provision is usually in lieu of dower, and is subject to the tax. In cases of intestacy she takes not only dower and homestead interests but certain specific personal property, such as clothing, jewelry and personal ornaments, a certain allowance pending the settlement of the estate, and a certain portion of the personal property varying from one-half to an amount equal to that of a child. These provisions are made by the same law that provides dower and homestead, and the reasoning of the Illinois court that all such provisions be broadly covered by the term "intestate laws" would seem the more reasonable and less technical construction.

Many other technical and more or less difficult questions arise

in the actual administration of the inheritance tax. Wills frequently provide for life estates with vested and contingent remainders, reversions, defeasible interests, and powers of appointment. The carving up of estates under such wills and the apportionment of the inheritance tax to the various interests are questions concerning which it is doubtful if the general reader will be interested. A sufficient variety of laws has been enacted and a sufficiently large and varied mass of court decisions has been rendered thereon so that several large-sized text books have been written upon the subject.

This tax produces nearly a million dollars a year in this state. In New York it produces several million dollars annually. It will, of course, produce an amount of revenue generally proportionate to the population and wealth of the state. It must be somewhat irregular in its operation from year to year, due to the uncertainty of human life. A number of unusually large estates may be offered for probate one year, and very few the next. These irregularities are accentuated where the county is taken as the taxing unit instead of the state. A single large estate has been known to pay more tax than all the other estates of the county paid in a half dozen or more years. Besides in the larger estates the property passing is not often confined to the locality or county, but is usually scattered in various parts of the state, often in several states. For these and other reasons, this should be a state tax and not a local or county tax.

It is certain that the inheritance tax has come to stay as long as the general property tax prevails, probably longer. It has been found a profitable source of income wherever put in operation.